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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

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REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

NOW COMES the Staff of the Illinois Commerce Commission ("Staff" and "Commission"), by and through its attorneys, and files its Reply Brief on Exceptions in the above-captioned proceeding. Briefs on Exceptions ("BOE") were filed on February 21, 2002 by Central Illinois Light Company ("CILCO" or "Company"), Illinois Industrial Energy Consumers ("IIEC"), the Citizens Utility Board ("CUB") and Staff. In addition, CILCO filed a

separate document titled “Exceptions of Central Illinois Light Company to Proposed Order” (“Exceptions”).

I. GENERAL AND COMMON PLANT AND A&G EXPENSES

CILCO incorrectly claims that “Assets or expenses that are not capable of direct assignment were allocated between the generation and delivery service functions **using the same general allocator supported by Staff and IIEC, and approved in CILCO’s prior delivery services rate case.**” (CILCO BOE at 3; emphasis added.) On the contrary, Staff notes that, in fact, the AF1-Payroll Allocator, recommended by Staff and IIEC, includes all costs, prior to any “direct assignments”, which is, in reality, the approach approved in CILCO’s previous delivery services case. In the instant proceeding, CILCO applied numerous other types of allocators to various general and common plant and administrative and general (“A&G”) expenses “after” direct assignment of some costs. By definition, allocating the remaining costs after direct assignment does not conform to the approved methodology from CILCO’s previous delivery services rate case.

A. General Plant

CILCO does not take exception to the Proposed Order’s findings in regard to General Plant (CILCO BOE at 6), presumably because the Proposed Order accepts an amount of General Plant allocated to electric distribution that is $6,188,075 over the amount recommended by Staff and IIEC, and much closer to the amount recommended by CILCO. However, Staff notes that CILCO does not agree with the Proposed Order’s finding that a general labor allocator should be used to functionalize remaining General Plant assets that are not appropriately directly assigned. For example, CILCO objects to

the Proposed Order's finding that 69% of the Pioneer Park facility should be allocated to distribution, instead of 100% as recommended by CILCO. Under Staff's recommended approach, 46% of the facility would be allocated to distribution. CILCO's position highlights the potential difficulty presented when specific cost items are allocated in a different manner from the approved overall approach. As noted by IIEC, "The Proposed Order, while acknowledging the unsuitability of General Plant and Common Plant costs being subject to direct assignment, disregards this finding for Account 396." (IIEC BOE at 8.) In Staff's view, this difficulty can be resolved by using the AF1-Payroll Allocator for all General Plant accounts.

B. Common Plant

Staff continues to support the Proposed Order's findings that the AF1-Payroll Allocator should be used for Common Plant. CILCO objects to the Proposed Order's findings (CILCO BOE at 6), but does not provide any new support to bolster its "residual approach to direct assignment". (Proposed Order at 31.) Thus, CILCO's proposal to directly assign the computer software system and the Peoria Office building should be rejected.

C. Administrative and General Expenses

Staff believes that CILCO's argument that the Proposed Order's composite allocator for A&G of 56% should be changed to 66% should be rejected. CILCO proposes to add the computer software system, classified under Common Plant, to alter the ratio between electric distribution general and common plant and total electric common and general plant. (CILCO BOE at 7-8.) As noted above, there is no justification for changing

the Proposed Order's finding related to Common Plant. Thus, there is no reason to alter the composite allocator ratio. However, in regard to overall A&G allocation, Staff's position continues to be that a general labor allocator (AF1) should be used to assign costs. (Staff BOE at 2-4.)

II. I-74 PROJECT

It is Staff's position that the conclusion reached in the Proposed Order to allow only costs already expended for the I-74 project is appropriate, given the evidence in the record. (Proposed Order at 41.) In defense of its position that all of the requested costs are known and measurable, the Company provided a schedule titled "I-74 project Information" and copies of letters from the Illinois Department of Transportation ("IDOT"). (CILCO Exhibit 1.4.) As pointed out in Staff's Initial Brief, these documents, which the Company perceives as supportive of its position, only serve to prove that the projected costs are **not** known and measurable. The schedule, which CILCO contends proves the cost of the project, only illustrates the uncertainty of the project because the total has changed by 11.5% since the inception of the case, 19 of the 21 listed projects still have only Preliminary Plans, and 2 of those 19 projects with Preliminary Plans indicate an uncertainty regarding any potential conflicts between IDOT plans and CILCO property. (Staff Initial Brief at 10.) The IDOT letters, which CILCO contends prove the timing of the project, prove only that the dates provided for completion of the projects may, and in some cases already have, changed throughout the course of the project. (Id. at 11.) These documents indeed support Staff's position that the work is not reasonably certain to occur within the 12-month window allowed by 83 Ill. Adm. 285 and that the cost is not currently

determinable. (Proposed Order at 41.). Therefore, the Proposed Order relative to this issue should be approved.

In its Brief on Exceptions, CILCO repeatedly misrepresents Staff's testimony during cross-examination. (CILCO BOE at 8-10.) While Staff witness Ebrey states that if she had received the letters from IDOT regarding the I-74 project, she would probably proceed with the projects, her testimony goes on to state that the timing is not identified with enough certainty to include the project in total in rate base. (Tr. at 188-189.) In response to CILCO's somewhat generic question regarding engineering estimates being a reasonable basis for cost determination for a lending institution, Staff witness Ebrey agreed that this factor would seem to be something reasonable to rely upon. (Tr. at 170-171.) Nowhere in the record does Staff witness Ebrey agree that CILCO's engineering estimates provide a reasonable basis for determining the costs of the I-74 project. To the contrary, Staff contends that the support provided by CILCO does not provide a reasonable basis for determining costs for the I-74 project. (Staff Initial Brief at 9, citing ICC Staff Exhibit 1.0 at 11-12.)

In citing prior Commission decisions regarding "known and measurable changes," the Company fails to recognize the distinct differences between the instant proceeding and those it cites. (CILCO BOE at 10-11.) In the Central Illinois Public Service Company ("AmerenCIPS") proceeding, the retail electric supplier ("RES") account executive position was defined with respect to job description, salary, and timing of the hiring to the satisfaction of the Commission. (Order, Docket No. 00-0802 at 53.) In the instant proceeding, the Proposed Order correctly finds that the record does not demonstrate that the work is "reasonably certain" to be completed within the 12-month window and that the

cost is currently "determinable". (Proposed Order at 41.). While there was a job description developed and a salary level set for the RES account executive in the AmerenCIPS proceeding, there are no final plans for the I-74 project and thus the cost cannot be defined with a reasonable degree of certainty.

In citing the Illinois Power Company Proposed Order (CILCO BOE at 11), the Company fails to understand that the key element of the known and measurable criteria identified by Staff was for that specific docket. Staff's position is reflected in the Proposed Order for the Illinois Power Company proceeding:

> Staff expounds that IP presented evidence of the processes that comprise the development of capital projects, from identification, initial and final design, costing and funding approval for plant additions. Staff notes that it determined that the key element of the known and measurable criteria to apply **in this docket** is the funding approval by management. According to Staff, the funding approval is the element of the known and measurable criteria that, **in this docket**, provides evidence of reasonable certainty for amounts in addition to actual amounts expended by the Company. Staff concludes that the projects, for which the Company has provided evidence of a funding approval, are both known and capable of being measured with reasonable certainty.

(Proposed Order, Docket No. 01-0432 at 19; emphasis added.)

Nevertheless, CILCO's contention that the evidence is undisputed that CILCO had approved the funding for the I-74 projects (CILCO BOE at 11) is simply false. In its response to Staff Data Request TEE 2.09 (ICC Staff Exhibit 11.0, Attachment A), the Company stated, "Work orders are prepared for those budget items approved for funding." The problem is further compounded by the Company's response to Staff Data Request TEE 5.08 (ICC Staff Exhibit 11.0, Attachment B), which states, "Where work order numbers exist and facesheets were not provided, projects are in the design stage". Most of the 21

projects listed as part of the overall I-74 project do not have work order numbers assigned, thus, by the Company's own admission, funding approval does not exist. Further, even when a work order number does exist, a project may still be in the design stage, therefore increasing the uncertainty of the project. (ICC Staff Exhibit 11.0 at 4.)

The record regarding this issue clearly supports Staff's adjustment. Staff urges the Commission to approve the conclusion reached in the Proposed Order.

III. PENSION AND OPEB EXPENSES

The Proposed Order correctly disallows CILCO's proposed revision of pension and other post-employment benefits ("OPEB"). (Proposed Order at 52.) The basis for the Company's revision was an actuarial projection for the year 2002, using estimated asset values as of December 31, 2001, based on September 30, 2001 actual asset values. The Company revised its initial filing in rebuttal testimony to include expenses that are derived from an actuarial projection for 2002 that is not known and measurable. (CILCO Exhibit 10.2 at 11.)

Although the projection was completed by an independent public accounting firm using the same methodology as the annual valuation, it is almost certain that the final outcome of the actuarial valuation for 2002 will be different; the actual asset values as of December 31, 2001 will be different than the values that were estimated in October 2001 based on September 30, 2001 asset values. The Company maintains that an actuarial projection is interchangeable with an actuarial valuation when it states, "However, the record establishes that this simple difference in terminology elevates form over substance." (CILCO BOE at 12.) Staff strongly disagrees with this interpretation of the record. As a

practical matter, an estimate is used only when the actual outcome is not yet known. If the Company is using an estimate, then it has not met the requirements for known and measurable changes to test year operating results pursuant to 83 Ill. Adm. 285.150(e).

It is inappropriate to adopt the Company's proposed adjustment to pension and OPEB expense because it adjusts pension and OPEB expense to a projected level that is not known and measurable. The Company revised its filing to include expenses that are derived from an actuarial projection for 2002 which, for reasons discussed above, is not known and measurable. (CILCO Exhibit 10.2 at 11.)

Staff proposes to adopt the level of pension and OPEB expense provided in the 2001 actuarial valuations as the test year expenses. (ICC Staff Exhibit 12 at 6.) The 2001 actuarial valuations are the most recent valuations that are known and measurable. The Commission should adopt Staff's position, which consistently applies the actuarial valuations and properly applies the known and measurable standard.

IV. PAYROLL INCREASE

The Proposed Order correctly disallows the Company's pro forma increase to reflect a hypothetical 3% union wage increase beginning July 1, 2002 and continuing through June 30, 2003. (Proposed Order at 51.) Staff noted that the Company's pro forma adjustment of $299,000 is based upon an amount that includes not only union wages, but also administrative and general wages. (ICC Staff/Getz Cross Exhibit 1.) Accordingly, Staff's adjustment includes the portion of the increase related to administrative and general wages, $24,000, as well as the portion of the increase related strictly to union wages, $275,000. (ICC Staff Exhibit 2.0, Schedule 2.4.) The Company disagrees with the

Proposed Order and maintains that its pro forma adjustment does meet the criteria of Section 285.150(e) for known and measurable changes to historic test year operating expenses. Although the record is already marked heard and taken, the Company now asserts it has signed a letter agreement with the International Brotherhood of Electrical Workers union leadership that, if accepted by the membership, would extend the existing union contract and provide a 3% wage increase effective as of July 1, 2002. CILCO states that it plans to file a motion pursuant to Section 200.870 of the Commission's Rules of Practice to re-open the record to receive an affidavit showing these new facts. (CILCO BOE at 14.)

Although the Company provided CILCO Exhibit 1.2 showing that a 3% union wage increase was granted July 1 of each year since 1994, this does not mean that an additional 3% increase is certain to occur July 1, 2002. As Company witness Getz stated during cross-examination, a union contract for the period beyond July 1, 2002 is yet to be negotiated. (Tr. at 459-460.) Any Company attempt to re-open the record to provide new evidence that did not exist at the time the record was marked heard and taken should not be allowed, as Staff has no opportunity to examine the Company regarding the new material. Moreover, the addition of the new evidence, if allowed, would still not meet the requirements of Section 285.150(e) because neither the amount of increase nor the timing is certain. Even now, the letter agreement has not been accepted by the union's membership — at the time the record was marked heard and taken the letter agreement did not exist. Accordingly, the assumed increase is not known and measurable, as is required for such an increase to be included in test year operating results. In order to

support its position that the increase is known and measurable, the Company quotes from Section 285.150(e) as follows:

> However, section 285.150(e) of the Commission's rate case filing rules states that a utility may adjust its historical test year "for all known and measurable changes" in expenses, where such changes "are reasonably certain to occur" within 12 months from the filing date of the new tariffs and "the amount of the changes are **reasonably** determinable".

(CILCO BOE at 14; emphasis added.)

Staff notes that the word "reasonably" as quoted by CILCO in the last line above is not a part of Section 285.150(e). Section 285.150(e) requires that the amount of the changes be determinable. CILCO argues that it is reasonably certain that a new union contract will be negotiated. Staff does not dispute that a new contract will be negotiated. (Tr. at 313-314.) Staff's adjustment, however, is based upon the fact that the outcome of a future union negotiation process is not determinable in terms of the amount of payroll increase that may result. Hence, the amount is not determinable and the requirements of Section 285.150(e) have not been met. Finally, Staff notes that during cross-examination of CILCO witnesses Underwood and Getz by Staff Counsel, both witnesses agreed that Staff's adjustment, as described in ICC Staff Exhibit 2.0, Schedule 2.4, Adjustment for Payroll Wage Increase, already reflects the July 1, 2001 union wage increase for the twelve months ended June 30, 2002. (Tr. at 461, 501.)

V. PARENT COMPANY PAYROLL DISTRIBUTION EXPENSE

The Proposed Order correctly accepts Staff's adjustment to reduce test year operating expense by $317,000 (ICC Staff Exhibit 2.0, Schedule 2.9) to disallow the portion of Parent Company Payroll Distribution that relates to non-regulated functions.

(Proposed Order at 54.) As stated in Staff witness Pearce's direct testimony, Staff's adjustment is based on the Company's response to Data Request BAP 7.03. (ICC Staff Exhibit 2.0 at 17.) In rebuttal testimony, Company witness Underwood agreed to the adjustment (CILCO Exhibit 1.1-DST at 11.) Surprisingly, in surrebuttal testimony, Company witness Getz contradicted this position by saying that he disagreed with the adjustment. (CILCO Exhibit 10.5 at 7.) The Company continues to oppose the adjustment as unnecessary on the basis that the amount was not included in the revenue requirement. (CILCO BOE at 16.)

> Company witness Getz states in his surrebuttal testimony that:
>
> The amounts for parent company payroll were erroneously included in the distribution column of the payroll recap schedule C-8; however, these amounts were actually recorded in non-utility expense account 417.1, not to A & G Salaries account 920. Since the payroll was not charged to A&G expense there is no need for this adjustment.

(CILCO Exhibit 10.5 at 7.)

Staff witness Pearce, on cross-examination, indicated that the information provided by CILCO was insufficient to show that the $317,000 was excluded from test year operating expenses. She acknowledged that because of the insufficient information, she was unable to determine whether the amount was included in the revenue requirement and, further, whether Company witness Getz's testimony was incorrect. (Tr. at 308-309.) The Company now attempts to benefit from the confusion it has created when it states, "Thus the record contains no evidence contradicting CILCO's testimony that the questioned amount was not included in the Company's proposed revenue requirement, so the adjustment is unneeded." (CILCO BOE at 16.) Staff notes that Company witness Getz never stated that the amount was not included in the Company's filing. (CILCO Exhibit 10.5

at 7-8.) Staff further notes that while Mr. Getz contends that schedule C-8 is "erroneous", the Company did not provide Staff with a corrected schedule C-8. Nor did the Company submit supporting documentation to show that the amount of Staff's adjustment, $317,000, had not been included in the filing. Based on the information contained in the record, Staff believes the adjustment described in ICC Staff Exhibit 2.0, Schedule 2.9, is correct.

VI. METERING COST ALLOCATION ISSUES

Although the Proposed Order accepts Staff's recommendation regarding metering service costs (Proposed Order at 83-84), CILCO attempts to cloud the issue of what customers should pay for meter service costs. (CILCO BOE at 17-18.) In Staff's view, the key issue is that CILCO's so-called "costs of being prepared to provide metering service to customers who return to CILCO from an alternative meter service provider" (CILCO BOE at 17) are part of meter service costs that should be recovered through meter service charges, according to the findings in the Commission's Order in the unbundling proceeding, Docket No. 99-0013. Recovering such costs through the customer charge, as recommended by CILCO, would violate this finding. Staff's position continues to be that costs in Federal Energy Regulatory Commission ("FERC") account 370 should be allocated entirely to meters.

CILCO creates the problem because, in addition to meters, CILCO has assigned some FERC account 370 costs to a new subcategory of customer meter regulatory obligation ("cmro"), defined as "the costs related to the investments remaining on the records of the Company, for customers where their meter has been removed, as it relates to providing meter services." (CILCO response to Staff Data Request DLS-13; ICC Staff

Exhibit 6.0, Attachment 2.) CILCO's definition obviously means "customers that return from an alternative meter service provider." (CILCO BOE at 18.) In essence, CILCO intends to use the FERC account 370 subcategory of cmro to recover costs related to equipment that may no longer be used. (Staff believes that the question of whether such costs should be recovered at all must be decided outside this proceeding in light of CILCO's FERC Form 1 recorded information related to FERC account 370.) However, for purposes of establishing delivery services tariff ("DST") rates and charges, Staff does not agree that such costs should be recovered from all customers through the DST customer charge, as proposed by CILCO. Unless cost recovery for the cmro FERC account 370 subcategory is from meter service charges, a portion will inappropriately be recovered in the customer charge from all DST customers. As accepted by the Proposed Order, Staff's recommendation reflects 100% of revenue requirement recovery through meter service charges for all components of FERC account 370 costs, including cmro. As stated in the Proposed Order, Staff's recommendation is in compliance with the Commission's Order in Docket No. 99-0013.

Therefore, CILCO's exception should be rejected by the Commission.

VII. COLLECTION OF OATT CHARGES NOT PAID BY THE TSA OR RES

Although CILCO claims that it does not object to the Proposed Order's conclusions regarding the collection of Open Access Transmission Tariff ("OATT") charges not paid by a transmission service agent ("TSA") or retail electric supplier ("RTES"), CILCO improperly uses its BOE as a vehicle for a second brief to the Commission on its argument. CILCO offers no language amending the Proposed Order and, although CILCO claims that it does

not object to the Proposed Order's language, it still maintains that "in no event should any retail customer be excused from responsibility for imbalance charges, since the energy to make up imbalances is provided by CILCO directly to the retail customer, and the customer has exclusive control over: (1) the energy usage that causes the imbalance charges to be incurred, and (2) the selection of its RES." (CILCO BOE at 20.)

CILCO claims that, "As a matter of law and policy, the retail end-user should remain ultimately liable for FERC jurisdictional transmission charges, including imbalance charges, if its Retail Electric Supplier (RES) fails to pay those charges and the security provided by the RES proves inadequate." (CILCO BOE at 18.) CILCO suggests that this approach is consistent with the law that requires transmission services to be provided to retail customers. (CILCO BOE at 18.) The law that CILCO alludes to is presumably the OATT. Although CILCO is correct that retail customers can be transmission customers under the OATT, CILCO conveniently leaves out the fact that a RES or other entity can also be a transmission customer under the OATT. Thus, CILCO's alleged "consistency" argument applies equally to a RES' responsibility for its transmission bills — not just the retail customer's responsibility. Since the RES or other entity, and not the retail customer, will procure transmission service under the OATT, then for consistency's sake the RES or other entity should be responsible for the bill instead of the retail customer, who has no knowledge or expertise in procuring these services.

As justification for requiring retail customers to be responsible for the unpaid transmission bills of their RESs, CILCO claims that it has no control over the retail customer's selection of a RES and is limited to requesting reasonable credit security. (CILCO BOE at 18.) CILCO has a great degree of flexibility and latitude in determining

reasonable credit security requirements for a transmission customer pursuant to the OATT. If CILCO exercises due diligence in examining the credit of a transmission customer, then it should be able to establish reasonable credit security requirements for a transmission customer that mitigate the cost of non-performance of the RES. Reasonable credit security requirements rarely equate to 100% guarantee cost recovery in any business, CILCO's transmission service included. Rather, they allow CILCO and the transmission customer to reasonably share a proportion of the costs associated with the risk of non-performance by the transmission customer. Instead of carrying out a due diligence review of a transmission customer, CILCO's approach is to ignore this responsibility and saddle the retail customer with all of the RES' unpaid transmission bills. Not only is CILCO's approach irresponsible to retail customers, but it also encourages non-creditworthy RESs to enter the market because the risk of non-performance is forced upon unknowing retail customers. Since CILCO appears to have no interest in discharging its responsibility to impose reasonable credit security requirements on a transmission customer, then CILCO should be willing, for consistency's sake, to withdraw the language from its OATT that allows the Company to establish credit security requirements for transmission customers. In fact, if CILCO's position of saddling uninformed retail customers with this liability continues, then there is no need for the credit security requirements language in the OATT. Instead of consistency, CILCO's position effectively absolves the Company of the responsibility to administer credit security requirements because the unpaid transmission bills can always be extracted from uninformed retail customers.

CILCO claims that it has no control over the retail customer's selection of a RES and is forced to do business with the retail customer's choice. (CILCO BOE at 18.)

However, a RES must obtain a certificate from the Commission to do business in CILCO's service area and CILCO can intervene as a party to the certificate proceeding for concerns regarding credit security. Thus, CILCO does in fact have a voice before the Commission regarding certification. Staff is not sympathetic to CILCO's concerns that it may be forced to do business with the retail customer's choice of supplier. CILCO is the monopoly provider of delivery services to all retail customers and RESs in its service area; perhaps retail customers and RESs share the same sentiment towards CILCO.

According to CILCO, another variable beyond CILCO's control is a retail customer's usage. Since CILCO cannot control a retail customer's usage, the Company wants the retail customer to be responsible for all unpaid energy imbalance charges incurred by its RES. (CILCO BOE at 19.) CILCO fails to mention that a retail customer has even less control over energy imbalances than CILCO because a retail customer has no knowledge of the usage of other retail customers who are served by the same RES. In other words, because energy imbalance charges are imposed by CILCO in the aggregate upon a RES, it is nearly impossible for a specific retail customer to know the extent of his or her liability for these charges as the result of the RES' non-performance; because retail customer A does not know the usage of retail customers B, C, and D. Furthermore, CILCO, as control area operator and balancer of the grid, is in a unique position to know its total system imbalance on a moment by moment basis and thus is in a much better position than any individual retail customer, to know the effects of fluctuations in usage on system operation. Thus, the alleged energy imbalance "problem" that CILCO alludes to is really a problem of financial settlement only. CILCO can mitigate its exposure to a RES' unpaid energy

imbalance charges by applying reasonable credit security requirements that take into account the retail load served by a RES.

CILCO claims that it is restricted by regulations in the amount of credit security it can require. (CILCO BOE at 19.) CILCO is silent as to the "restrictions" of the regulations, but from reviewing the Credit Security section of CILCO's OATT, it appears that CILCO has a great deal of flexibility under these "restrictions." CILCO's OATT states:

> For the purpose of determining the ability of the Transmission Customer to meet its obligations related to service hereunder, the Transmission Provider may require reasonable credit review procedures. This review shall be made in accordance with standard commercial practices. In addition, the Transmission Provider may require the Transmission Customer to provide and maintain in effect during the term of the Service Agreement, an unconditional and irrevocable letter of credit as security to meet its responsibilities and obligations under the Tariff, or an alternative form of security proposed by the Transmission Customer and acceptable to the Transmission Provider and consistent with commercial practices established by the Uniform Commercial Code that protects the Transmission Provider against the risk of non-payment.

(CILCO OATT, Section 11.)

CILCO acknowledges that credit security requirements are not a cure-all and that seemingly reasonable credit security requirements may prove inadequate for unforeseen circumstances such as the recent collapse of Enron Corporation, which undertook RES activities in Illinois. (CILCO BOE at 19.) Staff agrees with CILCO, but recognizes that the goal is not to establish a 100% guarantee of cost recovery for CILCO, which effectively extends the "stranded cost" mentality to transmission service. Currently, the only credit security requirements, Staff is aware of, that are imposed upon RESs are the requirements set forth in 83 Ill. Adm. Code 451. If CILCO has serious concerns that current credit security requirements are inadequate, then CILCO should increase its requirements, even

if that means increasing costs to a RES. If the RES is unable to meet reasonable credit security requirements, then that RES should exit the market.

It is not a foregone conclusion that a RES can simply pass the cost of increased credit security requirements along to retail customers. A retail customer must agree, explicitly or implicitly (if the costs are rolled in to rates), by accepting the RES' offer for service. In addition, if competition increases in the retail market, it is not possible for a RES to simply pass the cost of credit security requirements to retail customers since customers have viable options and not all RESs will face the same credit security requirements and costs.

Regarding agency concerns, CILCO claims that the complexity of procuring transmission service is not an presently issue and that, "Ordinary people routinely engage persons with special expertise to act on their behalf in matters beyond their usual capabilities." (CILCO BOE at 19.) CILCO's wording may be accurate, but it has nothing to do with the alleged agency relationship that it attempts to describe. CILCO cannot create an agency relationship between a retail customer and an unaffiliated third party simply by assertion in its tariffs. Neither the OATTs nor the delivery services tariffs allow CILCO to assert contractual obligations that are binding between other parties. CILCO must have documented proof that an agency relationship exists between the retail customer and the RES for the purposes of procuring transmission services before CILCO can bill a retail customer for the unpaid transmission bill of his or her RES.

Finally, CILCO has suddenly introduced the notion that, if Staff's position is adopted, it should apply only to residential customers. CILCO is misstating the record in this proceeding when it asserts that it is, "merely pointing out that the record does not support

extending the Staff's proposal to non-residential customers." (CILCO BOE at 20.) Staff's proposal was made for and applies to all retail customers of CILCO regardless of their classification as residential or non-residential customers. Each of Staff's arguments is applicable to residential and non-residential customers and should be approved as such by the Commission.

VIII. SHORT-TERM DEBT

Staff objects to CILCO's proposed language regarding the short-term debt issue. (CILCO Exceptions at 5; CILCO BOE at 20-21.) CILCO's proposal adopts the highly flawed logic that is thoroughly critiqued in Staff's Initial Brief. (Staff Initial Brief at 30-34.) Furthermore, CILCO's proposal to exclude short-term debt from its capital structure deviates from the precedent established by previous Commission Orders that include short-term debt as a capital structure component despite zero balances for periods exceeding two days. In Docket No. 95-0076, Illinois-American Water Company projected zero balances for short-term debt outstanding at the end of three months out of twelve and the Commission nonetheless concluded that short-term debt should be included in capital structure. (Order, Docket No. 95-0076, December 20, 1995 at 51-52.) Likewise, in Docket Nos. 93-0301/94-0041 (Cons.), the Commission adopted a capital structure that included short-term debt although GTE North Incorporated ("GTE") had a zero short-term debt balance during the rate proceeding. Nevertheless, GTE's capital structure for ratemaking purposes included short-term debt since the company normally had short-term debt outstanding. (Order, Docket Nos. 93-0301/94-0041 (Cons.), October 11, 1994, at 48, 52-53.) Accordingly, Staff believes that on this issue, the only changes needed to the

Proposed Order are those proposed by Staff as noted in its Brief on Exceptions. (Staff BOE at 12-16.)

IX. COST OF COMMON EQUITY

The Company criticizes the Proposed Order's conclusions regarding CILCO's cost of common equity and proposes several changes for incorporation into the Post Exceptions Proposed Order. (CILCO BOE at 21-27.) The Company's exceptions focus on two main arguments. These are largely the same arguments the Company presented in its Initial Brief, which Staff has addressed. However, the Company has made several statements that require further response. None of the Company's exceptions to the Proposed Order are valid and none of the changes proposed by the Company should be accepted.

A. Exclusive Reliance on Gas Sample

The Company argues that Staff's exclusive reliance upon its natural gas utility sample produces a defective final rate of return recommendation. The Company notes that if Staff had used the midpoint of the averages of the discounted cash flow ("DCF") and capital asset pricing model ("CAPM") results for both its Electric and Gas Samples, the indicated rate of return would equal 11.22%, after adding Staff's 0.07% flotation cost adjustment. The Company suggests that Staff's methodology is inconsistent with that used by Staff in MidAmerican Electric Company's ("MEC" or "MidAmerican") current DST proceeding, Docket No. 01-0444. (Id. at 22.)

Staff disagrees. As previously explained, Staff used the same methodology in both proceedings, but because of differing circumstances, Staff arrived at a different conclusion

regarding which sample, or combination of samples, best represents the target company in the instant docket. (Tr. at 249-250.) As explained in Staff's Brief on Exceptions, the Standard & Poor's credit and business profile ratings demonstrate that Staff's Gas Sample is more representative of CILCO's electric delivery services operations in terms of overall financial strength and business risk than Staff's Electric Sample. Therefore, Staff based its recommended return on common equity on its Gas Sample alone. Assigning any weight to the comparatively inferior Electric Sample in the calculation of the return on equity for CILCO's electric delivery services operations produces a worse estimate, not a better one. (Staff BOE at 17-18.)

The Company claims that Staff's refusal to consider its Electric Sample also represents an abrupt change from Staff's analysis in CILCO's last DST proceeding, Docket Nos. 99-0119/99-0131 (Cons.), in which Staff relied upon a single electric utility sample. (CILCO BOE at 22.) Again, Staff disagrees. The Company erroneously focuses on the results of an analysis rather than the facts and circumstances surrounding the analysis. The Company has not shown that the circumstances were the same in both proceedings.

Indeed, there are at least two obvious differences that led to Staff's differing conclusions. First, CILCO's last DST proceeding was part of the initial round of DST proceedings in Illinois. Since Illinois was among the first states to restructure the electric supply function, it stands to reason that few electric companies were facing competition in that area at that time. Thus, most integrated electric companies were fully regulated. That is no longer the case. To the contrary, many electric utilities have restructured, creating riskier unregulated generating subsidiaries, making them less suitable proxies for a fully

regulated delivery services operation. Second, the ten-company electric utility sample used by Staff in CILCO's last DST proceeding obviously differed in composition from Staff's six-company Electric Sample in the instant docket. The Company has not shown that these two samples reflected the risk level of CILCO equally well at their respective points in time. Regardless, in this proceeding, Staff has shown that its Electric Sample does not reflect the risk that CILCO's financial ratios exhibit as accurately as Staff's Gas Sample.

The Company also claims that Staff's reliance on its Gas Sample rests on speculation that "CILCO would have retained the AA- credit rating established in 1994 but for the acquisition of CILCO's parent company by AES Corporation" and that "CILCO's business profile would be 3 if not for the ownership of generation assets." (Id. at 22-24.) Staff has previously addressed this issue. (ICC Staff Exhibit 5.0 at 4-6, 21-22.) The record is clear that CILCO's stand-alone financial ratios have not deteriorated from the levels CILCO achieved when its credit rating was still AA- and that CILCO's credit rating was downgraded due to its affiliation with its non-utility parent, CILCORP, which greatly increased its debt to finance its acquisition by AES. (Staff Initial Brief at 44.) The Proposed Order correctly validates Staff's use of an AA- credit rating for selecting proxies for CILCO. In addition, CILCO's current business profile rating of 4, which reflects CILCO's ownership of risky generation assets, would almost certainly be raised to at least 3 if the Company divested its generation assets, as was the case following AmerenCIPS's recent generation divestiture. Nevertheless, even if Staff had used a business profile benchmark of 4, rather than 3, Staff would have continued to rely exclusively on its Gas Sample

estimate, since the average credit rating for the companies in the Gas Sample is closer to the AA- credit rating that CILCO's financial ratios merit. (Staff Initial Brief at 43-44.)

B. Sample Selection Criteria

The Company maintains that Staff's sample selection criterion requiring that comparable companies derive at least 70% of their revenues from natural gas or electric services is inconsistent with a standard utilized to construct comparable company samples in the MidAmerican docket. The Company concludes that this change in methodology allowed the inclusion of Consolidated Edison in Staff's Electric Sample, which resulted in a lower cost of equity recommendation. (CILCO BOE at 24.) As Staff has previously explained, the 70% cut-off was used in the instant proceeding in order to achieve a statistically large enough sample. (Tr. at 242-245.) Furthermore, the Company has failed to demonstrate that the 80% cut-off used in the MEC docket is an established standard to which Staff rigidly adheres. Staff submits that no such standard exists (indeed, the fact that Staff witness McNally did not adhere to this alleged standard indicates that it does not exist). Finally, the duplicity of the Company's argument is clear, since Company witness Morin also included Consolidated Edison in his sample. (CILCO Exhibit RAM-5.) The Company simply cannot have it both ways. It cannot fairly criticize Staff's sample selection criteria while advocating Company witness Morin's electric sample. The Proposed Order correctly accepts Staff's sample selection methodology. The Company offers no new arguments to change that conclusion.

The Company states that, after changing Staff's sample selection criteria, the average of the DCF and CAPM results for the Electric Sample (excluding Consolidated

Edison) and Gas Sample would result in a rate of return equal to 11.32%, including a 0.07% flotation cost adjustment. However, the Company concludes that the Proposed Order should reflect a cost of equity of 11.39% if it does not accept the recommendation of CILCO's rate of return witness. The Company does not explain how it derives this estimate. The Company merely suggests that an 11.39% cost of equity falls within the range developed by the Staff witness in this proceeding, is more in line with the rates of return recommended for comparable Illinois electric delivery services utilities in current DST proceedings, and is consistent with the comparability of returns approved in the last round of DST cases. The Company further states that "[i]t is incomprehensible how Staff could arrive at such different rate of return recommendations for MidAmerican (11.36%), and Ameren (11.39%) versus CILCO (11.02%)." (CILCO BOE at 24.)

The Company's statements suggest a fundamental misunderstanding regarding the composition of a company's overall risk. The Company frequently reminds the Commission of the alleged similarity in operating risk of the delivery services operations of Illinois electric utilities. This unsubstantiated assertion ignores the financial component of a company's overall risk. The levels of overall risk for these companies, as measured by their credit ratings, indicate that CILCO is less risky than other companies. Thus, investors do not require as high of a return for CILCO, since there is a positive correlation between risk and required return. (ICC Staff Exhibit 5.0 at 11.)

C. Other Arguments

The Company claims that Staff's 0.07% flotation adjustment understates CILCO's cost of equity by nearly 23 basis points. The Company also claims that the betas Staff

used in its CAPM analysis further understate Staff's recommended return by 60 basis points. (CILCO BOE at 21.) Finally, the Company suggests that the Commission should also consider adopting the rate of return on equity recommended by CILCO witness Morin. (Id. at 26-27.) All of these claims have been previously and thoroughly refuted by Staff. (Staff Initial Brief at 47-57.) The Proposed Order rightly rejects each argument. The Company has presented no new information that warrants changing the Commission's conclusion regarding this issue.

D. Final Language in the Proposed Order

The Commission should reject the Company's proposed language. (CILCO Exceptions at 5-8.) Rather, the Proposed Order should be altered to include the language changes proposed by Staff. (Staff BOE at 19-22.) Staff asserts that the cost of common equity for CILCO's electric delivery services operations is 11.09%. Accordingly, Staff believes that the overall weighted average cost of capital presented in the table on page 76 of the Proposed Order should be amended to reflect an overall cost of capital of 8.68% as follows:

Overall cost of capital			
Capital Component	Ratio	Cost	Weighted cost
Short-term debt	8.98%	2.04%	0.18%
Long-term debt	34.70	7.43	2.58
Preferred stock	5.71	5.43	0.31
Common equity	50.61	11.09	5.61
Total	100.00%		8.68%

For purposes of setting delivery services rates in this proceeding, Staff urges the Commission to conclude that CILCO be authorized to receive a return on delivery services rate base of 8.68%.

X. CUSTOMER AND SUPPLIER FEES

CUB disputes the Proposed Order's finding that CILCO adequately supported various customer and supplier fees. (CUB BOE at 5-10.) Staff agrees that the information that CILCO ultimately provided in response to Staff's request for cost support for the fees was not extremely detailed. Staff also agrees with CUB that CILCO does not establish with certainty whether existing employees would perform the tasks associated with the services for which fees are sought or whether new employees would be hired to perform those tasks. (Id. at 6-7.) However, after reviewing the information provided by CILCO, Staff ultimately concluded that CILCO had adequately justified the imposition of the fees that it proposes to charge. Therefore, Staff does not support CUB's suggestions to change the Proposed Order with respect to supplier and customer fees and recommends that the Commission reject the suggestions.

XI. ACCOUNT 908 PRO FORMA ADJUSTMENT

IIEC recommends adding a new section at the end of Proposed Order's discussion of contested issues regarding the $500,000 pro forma adjustment recommended by Staff with respect to Account 908 costs. (IIEC BOE at 11-12.) Although Staff agrees with IIEC's summation of the issue, Staff believes that modification of the Proposed Order is unnecessary. The Proposed Order already reflects this adjustment, which was not

contested by CILCO (CILCO Initial Brief at 20), as an uncontested issue. (Proposed Order at 48.)

XII. CONCLUSION

For the reasons set forth above, Staff respectfully requests that the Commission modify the February 14, 2002 Proposed Order in accordance with the reply exceptions set forth herein and the exceptions set forth in Staff's February 21, 2002 Brief on Exceptions and enter the modified Proposed Order as the Commission's final Order in this proceeding.

Respectfully submitted,

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